

Export Controls in UK Offshore Centers

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Many private equity and investment funds are organized as limited partnerships or companies of offshore entities. Similarly, companies may structure mergers and acquisitions by utilizing offshore holding entities. The British Virgin Islands and Cayman Islands are common jurisdictions for creating these offshore entities. These jurisdictions are 'Overseas Territories' of the United Kingdom, and, as such, an entity organized within the Overseas Territories, as well as its U.S. affiliates and international affiliates, must be cognizant of the potential applicable item-based export controls, sanctions, and embargoes ('export controls'), which may originate from the European Union, UK, or organically from the Overseas Territory itself.

Prior to organizing a business entity sensitive to export controls within the Overseas Territories, consider the following due diligence:

- Will item-based export controls for the Overseas Territory apply to transactions conducted by the new entity, thereby limiting or inhibiting the conduct of its intended business?
- Will country-based export controls for the Overseas Territory apply to the new entity, its directors or senior officers, thereby limiting or inhibiting the conduct of its intended business?
- Will end-user based export controls for the Overseas Territory apply to the new entity, its directors or senior officers, thereby increasing the financial sanctions which apply to transactions with listed legal persons, entities (companies) or bodies?

These due diligence questions provide a basis for going beyond the question of "business fit" to determine whether form

ing a business entity within the Overseas Territories introduces additional unforeseen export control compliance complexities. Providing answers to these due diligence questions requires an understanding of how EU and UK export controls extend to the Overseas Territories.

Overseas Territories of the United Kingdom

Within the British Empire, an Overseas Territory is not formally annexed; rather, the Crown receives power and jurisdiction by treaty, grant, or other lawful means. Each Overseas Territory has an independent constitution, government, and local laws. As a matter of constitutional law for each Overseas Territory, however, the UK Parliament has unlimited power to legislate for the Overseas Territories. An Overseas Territory's constitution sets forth the powers and responsibilities of the institutions of government within the territory, usually including a governor or commissioner, an elected legislature, and ministers. Her Majesty The Queen appoints a governor for the Overseas Territory based upon the advice of her ministers. Generally, a governor is responsible for external affairs, defense, internal security (including the police), and the appointment, discipline and removal of public officers.

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The UK provides the following support to the Overseas Territories:

- *Defense and security:* The UK commits to defend the Overseas Territories, assist with protection from crime, and provide support in the event of natural disaster;
- *Economic assistance:* The UK provides substantial need-based budgetary assistance;
- *International support:* The UK assumes, and is responsible for, the Overseas Territories' international relations, using diplomatic resources and influence to promote the Overseas Territories' interests; and
- *Reputational benefits:* The reputation of the Overseas Territory government and businesses are strengthened by association with the UK.

The UK has 14 Overseas Territories. Of those, the British Virgin Islands and the Cayman Islands remain popular centers for organizing business entities for international business transactions and are the focus of this article. Any reference to 'Overseas Territories' within this article includes the British Virgin Islands and the Cayman Islands.

EU and UK legislation affecting the Overseas Territories

The EU, consisting of 27 Member States, governs through seven institutions established pursuant to the Treaty on the Functioning of the European Union ('TEFU'). The two most important EU institutions are the EU Council and the EU Commission. EU legislative measures arise in different forms. First, EU legislative measures may be self-executing, such as EU regulations, whereby Member State compliance is mandatory without further execution by the Member State.

When enacted, it forms a part of the national law of the Member State. Conversely, EU legislative measures may simply provide instructions, such as EU directives requiring Member States to independently adopt specific supportive measures within their own national laws through the process of 'transposition'.

The TEFU sets forth the limits on EU legislative actions. As to EU export controls, EU jurisdiction can be summarized as follows: (1) export of military goods remains subject to national jurisdiction of the Member State; (2) export of dual-use goods is within the exclusive jurisdiction of the EU; and, (3) pursuant to the Lisbon Treaty of 2009, the Member States coordinate the adoption of unilateral country-based sanctions through Common Foreign and Security Policy ('CFSP').

The EU Military Goods Directive, TEFU Article 346(b)(1), provides 'any Member State may take such measures as it considers necessary for the protection of its essential security interests as connected with the production of, or trade in, arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the internal market regarding products which are not intended specifically military purposes.' EU Directive 2009/43/EC distinguishes between exports of 'defense related products' to destinations outside of the EU as opposed to transit of 'defense related products' within the EU. As such, export controls for military goods from a Member State outside of the EU are not directly covered by the EU Military Goods Directive, but rather created independently by each Member State.

The EU Dual-Use Goods Regulation, Council Regulation (EC) No 428/2009, provides a community-wide regime for controlling the exports, transfers, brokering, and transit of dual-use items. This regulation applies when an export is made from the EU, with the place of export determining applicable Member State jurisdiction. Although the EU Dual-Use Goods

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Regulation imposes mandatory EU-based rules, many of the provisions simply provide that the Member State must (or may) take action, but the EU Dual-Use Goods Regulations do not detail the required action.

Under the Lisbon Treaty of 2009, sanctions adopted by the CFSP may include sanction measures agreed upon at an international level by the United Nations, as well as EU-imposed unilateral sanctions. Unilateral EU sanctions apply globally to the acts of EU nationals, including any person holding nationality of a Member State, as well as any third-country person or entity doing business 'in part' within the EU. However, the enforcement of EU sanctions remains a matter of national law for individual Member States, and Member States may maintain differing thresholds as to sanction enforcement against a specific sanctioned country.

Since 2011, many EU sanctions have been extended to the Overseas Territories. EU legislation is not directly applicable to the Overseas Territories, so to extend the EU sanctions, the UK Foreign and Commonwealth Office ('FCO') drafts an Implementing Order in Council to the UK Overseas Territories ('UK Overseas Territory Sanction Orders'). These apply to all companies and partnerships established within the Overseas Territory, and usually include all aspects of the United Nations and EU sanctions measures stated within the EU Council Decision. The UK Overseas Territory Sanction Orders include enforcement provisions and information-gathering powers, requiring the Overseas Territory to implement the extended sanctions against individuals and businesses. The EU sanctions are wide in scope, often capturing direct and indirect dealings with specified countries, as well as persons or business entities within those countries.

The current UK government policy is to ensure that Overseas Territories are legally and practically enabled to implement the sanctions agreed upon by the UN and EU, so as to ensure the UK's compliance with international commitments. Also, under the British Virgin Islands constitution, the UK has authority to make laws for the 'peace, order and good of the government,' while the Cayman Islands constitution empowers the governor to withhold royal assent in cases where the legislation appears repugnant, inconsistent with the constitution, or affects the rights and privileges of the legislative assembly or the royal prerogative. While the UK does not have an obligation to extend EU export controls to the Overseas Territories, in practice it chooses to do so to maintain compliance with international policy commitments. Although the UK extends many EU export controls to the Overseas Territories, as exemplars this article focuses on how the UK extends the EU sanctions against Syria, Iran, and the munitions embargo against China to the Overseas Territories.

EU sanctions against Syria applicable to Overseas Territories

In response to the Syrian government's violent reprisals against civilian protests, the EU enacted sanctions against Syria in May 2011 by imposing asset freezes on natural and legal persons, entities and bodies, as well as restrictions on the provision of economic resources to such persons initially through Council Regulation EU 442/2011. As the situation in Syria continued to disintegrate, the EU enacted Council Regulation EU 36/2012, increasing the scope of sanctions affecting Syria on 19 January 2012. Later, on 17 June 2012, the EU imposed further sanctions through Council Regulation EU No. 509/2012 amending EU Regulation 36/2012.

The EU Syria sanctions are directly applicable to the UK. In order to detail the enforcement of certain restrictive measures provided by the EU Syria sanctions, the UK has implemented the EU Syria sanctions through statutory instruments, including the Export Control Syria Sanctions and Miscellaneous Amendments Order 2012 (SI 2012/810). On July 18, 2012, the UK further extended the EU Syria sanctions to the UK Overseas Territories through the Syria Order

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2012 No. 1755 ('UK Overseas Territory Syria Sanctions').

Thus, EU Syria sanctions include prohibitions applicable to entities of the Overseas Territories with regard to the following:

- The sale, supply, transfer or export of equipment or software intended for use by the Syrian regime in monitoring or interception of internet and telephone communications;
- The supply or transfer of specified equipment or technology to be used in certain oil and natural gas sectors in Syria or to Syrian-owned enterprises outside Syria;
- Participation in the construction of new power plants for the production of electricity in Syria, including through the provision of finance or financial assistance for such projects or the acquisition of shares in, or formation of joint ventures with, enterprises in Syria engaged in such projects;
- Prohibiting Syrian banks from opening new branches, subsidiaries or representative offices in EU Member States and from establishing joint ventures or acquiring an interest in banks within the EU;
- The provision of re/insurance to the Syrian government or entities controlled by the Syrian government; and,
- A comprehensive list of legal persons, entities (companies) or bodies to which financial sanctions apply.

EU Member States cannot provide loans or other forms of financial support to the Syrian government, and are subject to restrictions on the supply of banknotes and coinage to the Central Bank of Syria. The EU Syria sanctions apply extraterritorially to any EU national, to any legal person incorporated under the law of a Member State, and to any legal person in respect of any business done in whole or in part within the EU. Enforcement of the EU Syria sanctions is left to the Member States.

The UK Syria sanctions include an asset freeze on certain persons and entities, an arms embargo, trade restrictions, and restrictions on financial services as outlined under EU Regulation 36/2012. As extended to the Overseas Territory, a governor has the power to enforce the UK Overseas Territory Syria Sanctions, including the ability to delegate his powers for enforcement. The UK Overseas Territory Syria Sanctions apply to

- (i) any person in the British Virgin Islands or Cayman Islands, and other enumerated Overseas Territories,
- (ii) any person who is a 'British citizen, a British overseas territories citizen, a British subject, a British National (Overseas), or a British protected person and is ordinarily resident in the territory,' and
- (iii) any 'body incorporated or constituted under the law of the [Overseas] Territory' (collectively known as "UK sanctions covered persons").

EU Iran sanctions applicable to Overseas Territories

The EU Iran sanctions and UK Iran sanctions are blowing in the political winds of change. The time-limited Joint Plan of Action ('JPOA') affecting Iran, adopted by the EU on 20 January 2014, suspends the enforcement of certain EU Iran sanctions. Similar to an EU directive, to bring effect to the changes outlined in the JPOA, the UK must implement the JPOA within its own legal system. Currently, the UK policy is that there will be no changes to UK legislation as a result of

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the JPOA-based revisions reflected within the EU Iran sanctions.

Be that as it may, the foundation for Iran sanctions applicable to the Overseas Territories is premised upon Council Regulation (EU) 267/2012 from 24 March 2012, replacing EU Regulation 961/2010, implementing the EU Council Decision 2012/35/CFSP, and providing the main source of authority for the EU Iran sanctions. The EU Iran sanctions include prohibitions applicable to entities of the Overseas Territories with regard to the following:

- The supply of arms to, or purchase of arms from, Iran;
- The sale or supply of goods and technology which could contribute to Iran's proliferation activities;
- Providing assistance or financing in relation to prohibited goods;
- The importation or transportation of oil from Iran;
- The importation or transportation of petrochemical products from Iran;
- Financing any Iranian person or entity engaged in certain products from Iran;
- Financing any Iranian person or entity engaged in certain nuclear-related activities;
- Supplying equipment to any Iranian person, or for use in Iran for the exploration and production of oil or gas, or for use in the petrochemical industry in Iran;
- The sale or purchase of gold, precious metals or diamonds to or from Iran;
- The supply of newly printed banknotes and coins to Iran;
- Restrictions on financial transactions to or from Iranian persons or entities;
- The purchase of Iranian bonds; and,
- A comprehensive list of legal persons, entities (companies) or bodies to which financial sanctions apply.

The EU Iran sanctions apply extraterritorially

- (i) to any person who is a national of an EU Member State,
- (ii) to any legal person incorporated under the law of a Member State, and
- (iii) to any legal person in respect of any business done, in whole or in part, within the EU.

Enforcement of the EU Iran sanctions is left to the Member States, with the UK enacting enforcement measures through sanction orders.

The EU Iran sanctions are extended to the Overseas Territories in the same manner and process as the EU Syria sanctions. EU Iran sanctions are EU regulations directly applicable to the UK, which has implemented the sanctions through statutory instruments, including the Export Control (Iran Sanctions) Order 2012 (SI 2012/81243). Specifically, the UK has extended these to the UK Overseas Territories through The Iran (Restrictive Measures) (Overseas Territories) Order 2012 No. 1756 ('UK Overseas Territories Iran Sanctions'). The UK Overseas Territories Iran Sanctions effectively provide an asset freeze on certain persons and entities, an arms embargo and trade restrictions, and restrictions on financial services as outlined under the EU Iran sanctions.

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As with the Syria sanctions, the Overseas Territory governor has the power to enforce the UK Overseas Territories Iran Sanctions, and delegate any of its powers as necessary to enforce them. Also, similar to the Syria Sanctions, the UK Overseas Territories Iran Sanctions apply to UK sanctions covered persons.

EU arms embargoes and export controls extended to Overseas Territories

As discussed above, the EU extends to the UK directives for the export of military goods and regulations for the export of dual-use items. TEFU Article 346(b)(1) regulating EU military goods vests Member States with the ability to create national laws related to security regarding 'the production of or trade in arms, munitions and war material,' while Council Regulation (EC) No 428/2009 ('EU Dual-Use Goods Regulation') provides a community regime for controlling the exports, transfers, brokering, and transit of dual-use items. Again, the UK passes legislation implementing EU directives and providing details of implementation for the EU regulations.

The fundamental UK legislation supporting export controls is the Export Control Act 2002 ('UK Export Control Act 2002'). The act provides authority for the UK government to extend the export controls set forth in the UK Export Control Act 2002 through secondary legislation, i.e. orders exercisable by statutory instruments. The main piece of secondary legislation under the UK Export Control Act 2002 is the Export Control Order 2008 ('UK Export Control Order 2008') which controls: (1) the export of strategic goods; (2) the transfer of technology; (3) trade in goods; (4) trade in dual-use goods; and, (5) trade with countries subject to non-binding sanctions of the UN and EU, as well as (6) the UK Military List ('UK Military List'), and (7) UK Controlled Dual-Use Goods, Software and Technology ('UK Dual-Use List'). (Collectively (1) – (7) comprise the 'UK Strategic Controls List'.)

This UK Strategic Controls List applies to the Overseas Territories, as Her Majesty may, by UK Order in Council, extend any provision under the UK Export Control Act 2002 'to any British overseas territory' providing 'with such exceptions and modifications as appear to Her Majesty to be appropriate[.]' This enables the UK to extend EU directives and EU regulations to the Overseas Territories by implementing UK Orders in Council. UK Orders in Council are issued by the Queen under the powers of a given act due to the constitutional impact of extending legislation to the Overseas Territories. "Application of the EU China Military Embargo to Overseas Territories"

Application of the EU China military embargo to Overseas Territories

On June 27, 1989 in Madrid, the European Council of Ministers provided a Declaration on China, subjecting the country to a partial arms embargo and further restricting transit controls for military goods, 'strongly condemn[ing] the brutal repression taking place in China, [expressing] dismay at the pursuit of executions and requesting an end to repressive actions against those legitimately claiming their democratic rights.' In support of this policy, the ministers adopted a measure requesting 'interruption by the Member States of the Community of military cooperation and an embargo on trade in arms with China,' called the EU China Arms Embargo. The scope of the EU China Arms Embargo is not clearly defined, leaving Member States the power to interpret it differently by implementing enforcement policies within their own national laws.

The UK Export Control Order 2008 delineated the UK's position on the EU China Arms Embargo and requires a license for any product listed upon the UK Military List or UK Dual-Use List being exported to China. The order lists China within Schedule 4, Part 3, as subject to transit controls for military goods ('UK China Arms Embargo').

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The scope of the UK China Arms Embargo covers items listed on the UK Military List and includes the following:

- Lethal weapons, such as machine guns, large caliber weapons, bombs, torpedoes, rockets and missiles;
- Specially designed components and ammunition for the lethal weapons listed above;
- Military aircraft and helicopters, vessels of war, armored fighting vehicles and other such weapons platforms; and
- Any equipment which might be used for internal repression.

Exporters may apply for an export license as to items controlled under the UK Military List with the Export Control Organization ('ECO'), part of the Department for Business, Innovation and Skills. The UK ECO reviews these export license applications on a case-by-case basis in line with the Consolidated EU and National Arms Export Licensing Criteria.

The UK China Arms Embargo extends to the Overseas Territories. As mentioned, the UK has the authority to extend export controls to the Overseas Territories, under the Export Control Act 2002. In 2003, the UK passed The Export of Goods, Transfer of Technology and Provision of Technical Assistance (Control) Order 2003 No. 2764, also known as 'Export Control Order 2003' which was subsequently extended to the Overseas Territories in The Trade in

Controlled Goods (Embargoed Destinations)(Overseas Territories) Order 2004 No. 3101-3103 ('UK Embargoed Destination Order 2004'). Although, ultimately, the Export Control Order 2008 revoked the UK Export Control Order 2003, it remains applicable to the Overseas Territories through the UK Embargoed Destination Order 2004 which incorporates the definition of 'controlled goods' from the otherwise-revoked UK Export Control Order 2003.

The UK Embargoed Destination Order 2004 provides for the control of strategic goods, software and technology within the Overseas Territories, bringing together controls for the export or transfer of military and dual-use goods, software and technology and controls on goods, software and technology related to weapons of mass destruction ('WMD'), including the transfer of technology or provision of technical assistance in relation to the provision of WMD. The UK Embargoed Destination Order 2004 also extends the EU's Dual-Use Council Regulation No. 1334/2000 to the Overseas Territories as if they were part of the European Community. Schedule 1 of Export Control Order 2003 specifies military, para-military goods, software and technology, while controlled dual-use goods, software and technology are set forth in Schedule 2 of the UK Protectorate Export of Goods Order 2004.

The Export Control Order 2003, as extended to the Overseas Territories, is divided into six parts:

- Part I addresses controls for the export of military goods, dual-use goods and goods in transit with a WMD end-use;
- Part II addresses controls for the electronic transfer of military and dual-use technology and the transfer of technology with a WMD end-use by both electronic and non-electronic means;
- Part III addresses controls for the provision of WMD technical assistance;
- Part IV provides exceptions to the controls in Parts I, II and III;
- Part V provides for the granting of licenses, record keeping and appeals; and

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- Part VI addresses penalties and means of enforcement for breach of the controls in parts I, II and III.

The exceptions listed within Part IV of Export Control Order 2003 do not apply to the exceptions applying to embargoed destinations listed in Schedule 3. Because none of the Part IV exceptions apply to China, a license from an Overseas Territory's governor is required to export items on the UK Military List or UK Dual-Use List from an entity organized in the Overseas Territory to China.

Conclusion

Each entity organized within an Overseas Territory, as well its U.S. affiliates and international affiliates, must be aware of and understand all applicable EU, UK and Overseas Territory export controls. At a minimum, compliance will be necessary and certain transactions conducted by the business entity and its affiliates could be limited or inhibited by application of the applicable export controls. Due diligence directed toward clarifying the source of export control law providing the item-based, country-based, end-use based, and end-user based restrictions could provide the fundamental information necessary for tailoring an export controls compliance program effective within the Overseas Territories.

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